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SUBJECT: Peru - Investment Climate Statement 2010

REF: 09 STATE 00124006

¶1. In response to reftel, Embassy Lima submits the following 2010 Investment Climate Statement.

Openness to Foreign Investment

¶2. The Peruvian government seeks to attract investment -- both foreign and domestic -- in nearly all sectors of the economy. The U.S.-Peru Trade Promotion Agreement (PTPA), signed by President Bush and President Garcia on December 14, 2007 and entered into force on February 1, 2009, enables Peru to attract additional investment by clarifying rules for investors, increasing transparency, reducing barriers to trade, establishing faster customs procedures, and improving the dispute settlement process. The U.S. Congress extended unilateral trade preferences under the Andean Trade Preferences Act (modified by the Andean Trade Preferences and Drug Eradication Act, or ATPDEA) to Peru to December 31, 2010. The U.S. Government recognized Peru's progress in economic policy and other issues by selecting Peru for the Millennium Challenge Account's Threshold Program for fiscal year ¶2007. The program launched in 2008 and Peru has just completed its first year.

¶3. During the early 1990s, the Peruvian government promoted economic stabilization and liberalization policies by lowering trade barriers, lifting restrictions on capital flows and opening the economy to foreign investors. Peru experienced marked growth in foreign investment from 1993-1998. Economic reform and privatization slowed in the late 1990s however, leading to a discernible drop in direct and indirect foreign investment flows. Investment remained stagnant following the collapse of President Alberto Fujimori's government in November 2000, and through the period of an interim government and the election of President Alejandro Toledo in 2001.

¶4. During his tenure, President Toledo implemented several pro-investment policies. In April 2002, the government renamed COPRI, the privatization agency created in 1991, as ProInversion. ProInversion sought to be a "one-stop shop" for current and potential investors. Proinversion has successfully completed both concessions and privatizations of state-owned enterprises and natural resource based industries. ProInversion's current focus is on concessions. In 2004, Las Bambas, a copper deposit, was concessioned to Xstrata AG, a Swiss company, for US$121 million. In 2005, Bayovar, a state-owned phosphate rock deposit, was given in concession to a Brazilian company for a 3 percent royalty, and ProInversion granted British-owned Rio Tinto a concession for the La Granja copper deposit for US$22 million. Additionally, in 2006, the oil and gas leasing agency Perupetro granted 16 exploration concessions to foreign oil companies, including 9 to 5 U.S.

companies, along the northern coast and in the jungle. An additional 24 contract leases were signed to foreign oil firms in 2007 (10 to U.S. companies) and 20 leases were approved (pending signing) in 2008 (4 to U.S. companies). Implementation of the 2008 block awards had been delayed by allegations of corruption involving a certain bidder and Peruvian officials. Approximately 20 additional exploration blocks are expected to be concessioned in ¶2010.

¶5. In addition to the 1993 Constitution (enacted January 1, 1994) major laws concerning foreign direct investment in Peru include the Foreign Investment Promotion Law (Legislative Decree (DL) 662 of September 1991) which incorporates Legal Stability Agreements and the Framework Law for Private Investment Growth (DL 757 of November 1991). The two 1991 laws were implemented by Supreme Decree 162-92-EF (October 1992). Other important laws are the Private Investment in State-Owned Enterprises Promotion Law (DL 674), the Private Investment in Public Services Infrastructure Promotion Law (DL 758), and specific laws related to agriculture, fisheries and aquaculture, forestry, mining; oil and gas, and electricity, which are among the industries capable of receiving major FDI amounts in Peru. The Government of Peru has undertaken a decentralization process. The Base Law for Decentralization (DL27783 issued in 2002), the Organic Law on Regional Governments (DL27867), and the Organic Law of Municipalities (DL27972) facilitate and promote direct private investment with regional and local governments. Law N???? 28059, Framework Law for the Promotion of Decentralized Investment and its regulations approved through Supreme Decree N????

015-2004-PCM, sets forth the regulatory framework so that the State, at its three government levels (national, regional and local), may promote decentralized investment. The Government of Peru provides a link to these laws, the 1993 Constitution, and a listing of the Basic Rights of Foreign Investors on the Proinversion website.

¶6. The 1993 Constitution guarantees national treatment for foreign investors and permits foreign investment in almost all economic sectors. Article 6 under Supreme Decree N???? 162-92-EF authorizes foreign investors to carry out any economic activity of their choice to the extent this activity is not defined by the law as a crime and provided they comply with all constitutional precepts, laws and treaties. However, a few exceptions exist. For example, the law excludes from foreign investment activities in reserved natural protected areas and manufacturing of war weapons, pursuant to Article 6 of Legislative Decree N???? 757. The law reserves participation in the media, air and land transportation, and private security and surveillance exclusively to Peruvian investors or require a majority share of Peruvian investors. Prior approval is required in the banking (for regulatory reasons, and also applies to domestic investment) and defense-related sectors. Foreigners are legally forbidden from owning a majority interest in radio and television stations in Peru; nevertheless, foreigners have in practice owned controlling interests in such companies. Under the Constitution, foreign interests cannot "acquire or possess under any title, mines, lands, forests, waters, or fuel or energy sources" within 50 kilometers of Peru's international borders. However, foreigners can obtain concessions and rights within the restricted areas with the authorization of a supreme resolution approved by the Cabinet and the Joint Command of the Armed Forces.

¶7. In December 2008, the Government of Peru issued two important decrees aimed to prevent an economic slowdown in Peru caused by the global economic crisis by creating investment projects. The first one outlines the regulations for public and private investment ventures. The second one presents a priority list of projects for the public-private partnerships. Among these are major ports (Paita, San Martin, Pisco, Salaverry, Pucallpa, Iquitos, Yurimaguas) as well as some regional airport projects, a South American Integrated Regional Infrastructure Project (IIRSA) Center, water treatment and agricultural projects (Majes-Siguas and Chavimochic). As of November 2009, a number of these projects have been awarded, such as the port in San Martin and water treatment project in Majes-Siguas.

¶8. Under the 1993 Constitution, foreign investors have the same rights as national investors to benefit from any investment incentives, such as tax exemptions. The PTPA establishes a secure, predictable legal framework for U.S. investors operating in Peru. All forms of investment are protected under the PTPA. U.S. investors will enjoy in almost all circumstances the right to establish, acquire and operate investments in Peru on an equal footing with local investors.

¶9. Peru has improved its rankings on corruption, economic freedom, and ease of doing business. Peru remains in the MCC Threshold Program.

Transparency International Corruption Perceptions Index:

75

Heritage Index of Economic Freedom:

57

World Bank Ease of Doing Business Rank:

56

MCC Government Effectiveness:

40%

MCC Rule of Law:

23%

MCC Control of Corruption:

60%

MCC Fiscal Policy:

79%

MCC Trade Policy:

71%

MCC Regulatory Quality:

83%

MCC Business Start Up

31%

MCC Land Rights Access

65%

MCC Natural Resource Management

57%

MCC indicators are a percentile ranking in the country's peer group. (0% is worst, 50% is median, and 100% is best)

Conversion and Transfer Policies

¶10. Under Article 64 of the 1993 Constitution, the Peruvian

government guarantees the freedom to hold and dispose of foreign currency; hence, there are no foreign exchange controls in Peru. All restrictions on remittances of profits, dividends, royalties, and capital have been eliminated, although foreign investors are advised to register their investments with ProInversion to ensure these guarantees. Exporters and importers are not required to channel foreign exchange transactions through the Central Reserve Bank of Peru, and can conduct transactions freely on the open market. Anyone may open and maintain foreign currency accounts in Peruvian commercial banks. U.S. firms have reported no problems or delays in transferring funds or remitting capital, earnings, loan repayments or lease payments since Peru's economic reforms of the early 1990s.

¶11. The 1993 Constitution guarantees free convertibility of currency. There is, however, a legal limit on the amount that private pension fund managers can invest in foreign securities. Between May 2004 and April 2008, the Central Reserve Bank of Peru (BCR) gradually increased this limit from 9 percent to 20 percent. In October 2009, the BCR increased the limit to its current rate of 22 percent. Under the PTPA, portfolio managers in the U.S. are able to provide portfolio management services to both mutual funds and pension funds in Peru, including to funds that manage Peru's privatized social security accounts.

¶12. The BCR is an independent institution, free to manage monetary policy to maintain financial stability. The BCR's primary goal is to maintain price stability, via inflation targeting. Inflation at year-end in Peru was 3.9 percent in 2007, 6.7 percent in 2008, and 0.3 percent in 2009. The government has also implemented policies to de-dollarize the economy. Dollars accounted for about 52% of loans and approximately 56% of deposits as of January 2010

Expropriation and Compensation

¶13. According to the Constitution, the Peruvian government can only expropriate private property on public interest grounds (such as for public works projects) or for national security. Any expropriation requires the Congress to pass a specific act. The Government of Peru has expressed its intention to comply with international standards concerning expropriations.

Dispute Settlement

¶14. Dispute settlement continues to be problematic in Peru, although the GOP took steps in 2005 to improve the dispute settlement process. From December 2004 through 2006, the GOP established 24 commercial courts in Lima to rule on investment disputes, including two courts of appeal. The commercial courts have substantially improved the process for commercial disputes. Prior to the existence of the commercial courts, it took an average of two years to resolve a commercial case through the civil court system. These new courts, which have specialized judges, have reduced the amount of time to resolve a case to two months. Additionally, the enforcement of court decisions has been reduced from 36 months to 3-6 months. While about 40 percent of decisions are appealed, most of these are resolved at the appeals level; very few are appealed to the Supreme Court.

¶15. The criminal and civil courts of first instance and appeal are located in the provinces and in Lima. The Supreme Court is located in Lima. In principle, Peruvian law recognizes secured interests in property, both chattel and real. However, the judicial system is often extremely slow to hear cases and to issue decisions. In addition, court rulings and the degree of enforcement have been difficult to predict. The capabilities of individual judges vary substantially, and allegations of corruption and outside interference in the judicial system are common. The Peruvian

appeals process also tends to delay final decisions. As a result, foreign investors, among others, have found that contracts are often difficult to enforce in Peru.

¶16. The 1997 Law of Conciliation (DL 26872), which went into effect on January 1, 2000, requires disputants in many types of civil and commercial matters to consider conciliation before a judge can accept a dispute to be litigated. Private parties often stipulate arbitration to resolve business disputes, as a way to avoid involvement in judicial processes.

¶17. Peru's commercial and bankruptcy laws have proven difficult to enforce through the courts. An administrative bankruptcy procedure under INDECOPI (the National Institute for the Defense of Free Competition and the Protection of Intellectual Property), has proven to be slow and subject to judicial intervention. Peru has a creditor hierarchy similar to that established under U.S. bankruptcy law, and monetary judgments are usually made in the currency stipulated in the contract.

¶18. The 1993 Constitution includes international arbitration of disputes between foreign investors and the government or state-controlled firms. Although Peru theoretically accepts binding arbitration, on a few occasions over the past three years, parastatal companies and Government Ministries disregarded unfavorable judgments. Previously, the Government of Peru turned these arbitration cases over to the judiciary, where they were bureaucratically delayed until the companies conceded the cases. However, effective July 2005, the Supreme Court ruled that all arbitration findings and awards are final and not subject to appeal.

¶19. Peru is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention of 1958), and to the International Center for the Settlement of Investment Disputes (the Washington Convention of 1965). Disputes between foreign investors and the Government of Peru regarding pre-existing contracts must still be submitted to national courts. However, investors who conclude a juridical stability agreement for additional investments may submit disputes with the government to national or international arbitration if stipulated in the agreement. Several private organizations -- including the Universidad Catolica, the Lima Chamber of Commerce and the American Chamber of Commerce -- operate private arbitration centers. The quality of these centers varies, however, and investors should choose a venue for arbitration carefully.

¶20. The PTPA includes a chapter on dispute settlement. The core obligations of the Agreement, including labor and environment

provisions, are subject to the dispute settlement provisions of the agreement. Dispute panel procedures set high standards of openness and transparency through; open public hearings; public release of legal submissions by parties; special labor or environment expertise for disputes in these areas; and, opportunities for interested third parties to submit views. The Agreement emphasizes promoting compliance through consultation and trade-enhancing remedies.

Performance Requirements and Incentives

¶21. Peru offers both foreign and national investors legal and tax stability agreements to stimulate private investment. These agreements guarantee that the statutes on income taxes, remittances, export promotion regimes (such as drawback),

administrative procedures, and labor hiring regimes in effect at the time of the investment contract will remain unchanged for that investment for 10 years. To qualify, an investment must exceed US$10 million in the mining and hydrocarbons sectors or US$5 million in other sectors within two years. An agreement to acquire more than 50 percent of a company's shares in the privatization process may also qualify an investor for a juridical stability agreement, provided that the infusion will expand the installed capacity of the company or enhance its technological development.

¶22. There are no performance requirements that apply exclusively to foreign investors. Peruvian civil law applies to legal stability agreements, which means they cannot be altered unilaterally by the government. Investors are also offered protection from liability for acquiring state-owned enterprises.

¶23. Laws specific to the petroleum and mining sectors also provide similar assurances as above to investors. Notably, in 2000, the government modified the General Mining Law, substantially reducing benefits to investors in that sector. Among the changes were: a reduction in the term concessionaires are granted to achieve the minimum annual production; an increase in fees for holding non-productive concessions; an increase in fines for not achieving minimum production within the allotted time; a reduction in the maximum allowable annual accelerated depreciation; and revocation of the income tax exemption for reinvested profits. In 2004, Congress approved a bill charging a 1 to 3 percent royalty on mining companies' sales. The changes do not affect those investors who have signed legal stability agreements with the government during the lifetime of the agreement. Under the U.S.-Peru Trade Promotion Agreement, Peru agreed to eliminate a measure affecting any sector in which a government concession is needed, such as transportation, energy and mining, that requires U.S. enterprises to buy locally. U.S. companies will be free to purchase on the basis of price and quality, not origin of goods in these sectors.

¶24. In December 2006, after increased social demands for a share of mining profits, the Garcia Administration and mining companies agreed to a "voluntary contribution" system whereby mining companies will invest in community infrastructure projects. This agreement averted adoption of a more restrictive mining law, and allows mining companies to control where they invest their contributions, and ceases to apply if the prices of metals or minerals drop from certain levels.

¶25. Parties may freely negotiate contractual conditions related to licensing arrangements and other aspects of technology transfer without prior authorization. Registry of a technology transfer agreement is required for a payment of royalties to be counted against taxes. Such registration is automatic upon submission to ProInversion.

¶26. Current laws limit foreign employees to no more than 20 percent of the total number of employees in a local company (whether owned by foreign or national interests), and restricts their combined salaries to no more than 30 percent of the total company payroll. However, DL 689 (November 1991) provides a variety of exceptions to these limits. For example, a foreigner is not counted against a company's total if he or she holds an immigrant visa, has a certain amount invested in the company (currently about US$4,000) or is a national of a country that has a reciprocal labor or dual nationality agreement with Peru. The law exempts foreign banks and service companies, and international transportation companies from these hiring limits, as are all firms located in free trade zones. Furthermore, companies may apply for exemption from the limitations for managerial or technical personnel. With the entry into force of the U.S.-Peru Trade Promotion Agreement, Peru has agreed to

exceed its commitments made in the World Trade Organization (WTO), and to dismantle significant services and investment barriers, such as measures that require U.S. firms to hire nationals rather than U.S. professionals and measures requiring the purchase of local goods.

Right to Private Ownership and Establishment

¶27. Peruvian law generally grants foreign and domestic entities the right to establish and own business enterprises and to engage in most forms of remunerative activity. Subject to the restrictions listed earlier in this document, both foreign and domestic entities may invest in any legal economic activity -- including foreign direct investment, portfolio investment, and investment in real property. Private entities may generally freely establish, acquire, and dispose of interests in business enterprises. In the case of some privatized companies deemed important by the government, the privatization agency ProInversion has included a so-called "golden share" clause in the sales contract, which allows the government to veto a potential future purchaser of the privatized assets.

Protection of Property Rights

¶28. While the legal framework for protection of intellectual property rights (IPR) in Peru has improved over the past decade, enforcement mechanisms remain weak. Peru remains on USTR's Section 301 "Watch List" due to concerns about continued high rates of copyright piracy, and inadequate enforcement of IPR laws, particularly with respect to the relatively weak penalties that have been imposed on IPR violators.

¶29. The International Intellectual Property Alliance (IIPA) estimates that the piracy level in Peru for recorded music has remained at 98 percent since 2003, with trade losses estimated at US$57.2 million in 2008, a slight decrease from 2007 levels. The IIPA estimates that software piracy levels remained at 71% in 2008 , with a loss of $46 million in 2008. The most recent data available for motion picture piracy comes from a 2005 study conducted by the Motion Picture Association of America (MPAA). MPAA reported that motion picture piracy accounted for 63 percent of the market for a loss of US$12 million in 2005.

¶30. The Peruvian government agency charged with promoting and defending intellectual property rights is the Institute for the Defense of Competition and Protection of Intellectual Property (INDECOPI, http://www.indecopi.gob.pe ), established in 1992. Legislative Decree 822 of 1996 and Andean Community Decisions 344 and 486 protect patents, trademarks, and industrial designs. Copyrights are protected by Legislative Decree No. 822 of 1996 and by Andean Community Decision 351.

¶31. Peru belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). It is also a signatory to the Paris Convention on Industrial Property, Geneva Convention for the Protection of Sound Recordings, Bern Convention for the Protection of Literary and Artistic Works, Brussels Convention on the Distribution of Satellite Signals, Phonograms Convention, Satellites Convention, Universal Copyright Convention, the World Copyright Treaty, and the World Performances and Phonographs Treaty and the Film Register Treaty. In December 1994, the Peruvian Congress ratified the World Trade Organization's Agreement on Trade-Related Aspects of Intellectual Property (TRIPs).

¶32. Under the PTPA, each party shall ratify or accede to the following agreements: the Convention Relating to the Distribution

of Programme-Carrying Signals Transmitted by Satellite; the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure; the WIPO Copyright Treaty; the WIPO Performances and Phonograms Treaty; the Patent Cooperation Treaty; the Trademark Law Treaty; and, the international Convention for the Protection of New Varieties of Plants. Under the PTPA, each party shall make all reasonable efforts to ratify or accede to the following agreements: the Patent Law Treaty; the Hague Agreement Concerning the International Registration of Industrial Designs; and, the Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks.

¶33. Peru's legal framework provides for easy registration of trademarks and inventors have been able to patent their inventions since 1994. Peru's 1996 Industrial Property Rights Law provides an effective term of protection for patents and prohibits devices that decode encrypted satellite signals, along with other improvements. Peruvian law does not provide pipeline protection for patents or protection from parallel imports. Peru's Copyright Law is generally consistent with the TRIPs Agreement.

¶34. However, despite this legal framework, piracy of textbooks, books on technical subjects, audiocassettes, motion picture videos, and software prevails. While the government, in coordination with the private sector, has conducted numerous raids over the last few years on large-scale distributors and users of pirated goods, and has increased other types of enforcement, piracy continues to be a significant problem for legitimate owners of copyrights in Peru. The government needs to allocate more resources towards enforcement and effective deterrence measures.

¶35. Despite recent amendments to the legal code creating stricter penalties, the judicial branch has failed to impose sentences that adequately deter future IPR violations. The Peruvian government in July 2004 increased the minimum penalty for piracy to four year's imprisonment. Through PTPA implementation legislation passed by the Peruvian Congress in January 2009, the penalty for piracy increased to eight years of imprisonment.

¶36. An IPR Toolkit for Peru can be found on the Embassy and Commercial Service Lima's website ( http://www.buyusa.gov/peru/en/196.html). Besides being a guide to registering and protecting IP, it contains a list of lawyers and other organizations that can provide support on an on-going basis.

¶37. Under the U.S.-Peru Trade Promotion Agreement, in all categories of intellectual property rights (IPR), U.S. companies will be treated at least as well as Peruvian companies, and the agreement makes a number of important improvements to IPR protections. The Agreement provides for improved standards for the protection and enforcement of a broad range of intellectual property rights, which are consistent, both with U.S. standards of protection and enforcement and with emerging international standards. Such improvements include state-of-the-art protections for digital products such as U.S. software, music, text, and video; stronger protection for U.S. patents, trademarks and test data, including an electronic system for the registration and maintenance of trademarks; and further deterrence of piracy and counterfeiting of criminalizing end-user piracy.

Transparency of Regulatory System

¶38. The transparency and independence of regulatory processes have become central issues for foreign investors in Peru. Many of the central government entities with which foreign firms must deal -- including the entities that maintain the company registry and supervise securities and exchanges (CONASEV), handle privatization and investment issues (ProInversion), and handle competition policy and intellectual property matters (INDECOPI) -- have relatively transparent and predictable procedures. The Superintendence of Banking and Insurance (SBS) regulates banks, insurance companies, and private pension funds. The SBS determines the qualifications of potential market entrants and regulates firms once they have begun operations. Under the U.S. - Peru Trade Promotion Agreement,

U.S. financial service suppliers have full rights to establish subsidiaries or branches for banks and insurance companies.

¶39. When the Government of Peru (GOP) privatized state-owned monopolies in the areas of telecommunications, electrical generation and distribution, and the hydrocarbons sector in the late 1990s, it also established regulatory institutions to oversee the new private sectors. Delays and lack of predictability in the rulings of these institutions, including OSIPTEL (telecom) and OSINERGMIN (energy), have at times in the past been notable impediments to doing business in Peru.

¶40. In December 2005, OSIPTEL published a new law that lowers Peru's high mobile termination rates to levels comparable to international rates over a 3-year period. However, given the significant market changes since 2005, OSIPTEL is currently reviewing industry data submitted in December 2009 to re-evaluate the current rates. Several U.S. companies have encountered problems with the energy sector regulator (OSINERGMIN) over its hesitancy to provide unbiased regulation for the power industry. Some regulatory agencies have in the past been subject to politically motivated government intervention in their technical operations.

¶41. U.S. firms have complained that SUNAT's (Peruvian Tax and Customs Agency) aggressive behavior and interpretation of law are often contrary to the spirit of the law and intent of government policies, complicating normal business operations. The remuneration of SUNAT employees is determined, in part, by the theoretical tax liability they uncover in audits.

¶42. Businesses point out that SUNAT's retroactive reinterpretation of regulations and laws, its levying of disproportionate fines, and initiation of full company audits when companies request a refund or legal revaluation of assets for depreciation purposes, create additional investment and trade barriers. In one case, a U.S. firm requested an improper drawback of US$1,345, only to face SUNAT fines of US$645,000. Although the case was resolved, new legislation was needed to correct the problem. In instances involving airplane fuels and other products sold to carriers just before they leave the country, certain minerals, and other products, SUNAT for many years treated these goods as if they were sold abroad, which under Peruvian tax laws are exempt from domestic sales taxes. SUNAT reinterpreted the regulations and no longer considered the goods as exports and therefore wanted to retroactively subject the goods to VAT plus penalties. Two laws were necessary to correct this practice for airline and seagoing vessels' fuels and services. SUNAT often does not follow standard international practice in the way it taxes new activities. To correct these problems, the independent tax tribunals act to check any abuses by SUNAT, but as a matter of course SUNAT normally appeals tax tribunals' rulings, thereby extending indefinitely the resolution of disputed assessments. In 2004, the GOP established a tax ombudsman who must approve SUNAT's request to appeal adverse tax tribunal decisions. In the past two years, the tax ombudsman

has acted in several cases to end unwarranted litigation of disputed assessments. In 2005, a U.S. company won long-standing tax cases against SUNAT as a result of these improvements. In another instance, a minor error on a shipping document resulted in the seizure of a U.S. firm's shipment by SUNAT, with the goods destined for disposal at auction.

¶43. The World Bank 2010 report on Doing Business moves Peru to 56 up from 65 in the global ease of doing business ranking. Peru completed reforms in six of the ten areas measured including reformed business start-up, property registration, and contract enforcement, made it easier to pay taxes, and sped up international trade. Peru has significantly lowered the average amount of days it takes to start a business from 72 in 2008 to 41 in 2010. Additionally, Peru has eliminated one step for starting a business. The World Bank report discusses the nine procedures for starting a business in Peru. Businesses have complained about the 19 percent value added tax on goods, high social security tax rates, and certain labor laws, which increase investment costs significantly and hinder the efficient mobilization and allocation of investment capital. Businesses can apply for VAT reimbursement.

Efficient Capital Markets and Portfolio Investment

¶44. Credit is allocated on market terms and the banking industry in Peru is generally considered to be competitive in offering services to business customers. Private pension funds have competed in recent years with financial companies for bonds issued locally by companies and the Government of Peru, as supply of securities is insufficient given the small size of the market. Foreign investors can obtain credit and float bonds on the local market and several of them have done so in the last few years as terms continue to be more competitive than those of the usual international centers. The private sector has access to a variety of credit instruments. In December 2009, , firms placed US$1.7 billion on the local bond market, a new record and a big recovery from the sharp fall of 2008, when placements totaled US$1.4 billion. Mutual Funds managed US$4.9 billion in December 2009, a large recovery from the November 2008 level of US$2.8 billion but still below the record level of US$5.2 billion of July 2008. By November 2009, pension funds managed a total of US$23.73 billion, a strong recovery from the October 2008 level of US$14.4 billion. All firms listed on the Lima Stock Exchange (Bolsa de Valores de Lima) or the Public Registry of Securities must be vetted by CONASEV, the National Commission for the Supervision of Companies, Securities and Exchanges, which maintains the Public Registry of Securities and Stock Brokers. CONASEV is the Peruvian government entity charged with the study, promotion, and regulation of the securities and commodities markets; the control of market participants; the maintenance of a transparent and orderly market; the setting of accounting standards; and the publication of financial information about covered companies. As part of CONASEV's goal to promote market transparency, to prevent monopolies, and to prevent fraud, issuers of stock are required to inform CONASEV and the relevant stock exchange or body in charge of supervising the centralized trading mechanism, of events that affect or might affect the stock, the company, or any public offerings. Although trading on insider information is technically a crime, no one has been charged and punished under the law.

¶45. In 2008, the global financial crisis severely hit the local capital markets. The Lima Stock Exchange (BVL), suffered the worst hit showing an almost continuous decline beginning in July 2007, dominated, as it is, by mining shares. The BVL General Index reached an all-time high of 23,418 in July 2007, and tumbled consistently until October 2008, when it reached 7,055 points. Since March 2009, the index began a steady recovery hovering around the 15,000 level from September 2009 until early 2010, making it the world's fifth most profitable stock exchange at 99% in 2009. Since most pension funds (AFPs) are invested locally, the private pension funds companies and mutual funds also took a severe pounding but by September 2009 the AFPs had recovered the losses

since June 2008, with its fund reaching a value of USD$23.8 billion in December 2009

¶46. Total assets of the commercial banks were US$48.9 billion at the end of November 2009, 3.4% above the same period of 2008. The banking system is considered generally sound. The 2008-2009 global financial crises has not affected local operating banks, a reflection of sound banks policies aimed at strengthening their position after the lessons learned during the 1997-1998 Asian crisis; sound and able bank supervision, and strong GDP growth in the last few years until 2008. Although GDP growth was substantially lower in 2009, it was still positive according to most forecasts. Opening of the economy since the 1990s coupled with competition, have led to a significant consolidation in the sector, which still continues with two new foreign banks being authorized in 2008 to operate locally, and one (foreign-owned) financial company to operate as a bank. Fifteen commercial banks comprise the system, of which 3 banks account for two-thirds of loans and over four-fifths of deposits. Banks have revamped operations, increased capitalization, and reduced costs in recent years. As of November 2009, foreigners had significant shares in twelve banks, of which they were majority owners of ten (including two of the country's large ones, and operator of one commercial bank. Under the SBS's conservative criteria, 1.6% of total loans were assessed as non-performing as of November 2009, down from a high of 11% in early 2001 and very low since 2005. The system has 6 specialized institutions ("financieras"), 34 thriving micro-lenders and savings banks, two state-owned banks, and one state-owned development bank.

¶47. Larger private firms often use "cross-shareholding" and "stable shareholder" arrangements to restrict investment by outsiders -- not necessarily foreigners -- in their firms. As close families or associates generally control ownership of Peruvian corporations, hostile takeovers are practically non-existent. Peruvian law and regulations do not authorize or encourage private firms to adopt articles of incorporation or association to limit or restrict foreign participation; nor are there any private or public sector efforts to restrict foreign participation in industry standards-setting organizations.

¶48. Foreign direct investment as of September 2009 was US$34.7 billion, compared with US$31.6 billion a year earlier. Foreign portfolio investment (dematerialized holdings of securities at the Lima Stock Exchange only) totaled US$60.6 billion at the end of November 2009, up from 39.4 billion in December 2008, and 57.0 billion in December 2007.

Competition from State-Owned Enterprises (SOEs)

¶49. In 1991, the Peruvian government began an extensive privatization program, encouraging foreign investors to participate. From 1991 through September 2005, privatization revenues totaled US$9.4 billion, of which foreign investors were responsible for the vast majority. Over three-quarters of these transactions took place from 1994 to 1997. The government has since shifted to a strategy of promoting multi-year concessions as a means of attracting investment into major projects. In 2000, the government granted a concession to a private group (Lima Airport Partners) to operate the Lima airport and in June 2006, the government granted a consortium of P and O Dover (U.K.) and Uniport (Spain) a 30 year concession to operate the Container Terminal-South Pier of the important seaport of Callao. Also in 2006, Dubai Ports signed a concession agreement to build and operate a new container terminal within the Port of Callao. The facility is expected to become operational in 2010. In August 2006, Swissport received a 25 year concession to manage nine of Peru's northern airports. The GOP has been soliciting bids for 25 year concessions to manage six of Peru's southern airports, as well

as, multi-year concessions for various energy, natural gas, hydro-energy and irrigation, telecommunications, ports, sanitation, land transport, trains, and tourism projects, some of these bids have been postponed. Several electricity, water, sewage, bank, and oil (Petroperu) companies remain state-owned and operated.

¶50. In June 2004, the Congress passed a law to exclude state-owned oil company Petroperu from privatization and authorized Petroperu to conduct exploration and production activities. This modified the government's policy since the early 1990s, when it sold all of Petroperu's exploration and production units and a major oil refinery. Under the 2004 law, the government had the option of granting concessions on remaining Petroperu assets, including one pipeline and several refineries. In July 2006, Congress defeated an executive veto of a bill to "strengthen and modernize" Petroperu. Under the 2006 law, the government authorized Petroperu to resume exploration, production and related activities, including petrochemicals; was freed from contracting approval by CONSUCODE, the state procurement supervision agency; was exempted from the approval of its investment projects by the Government Projects Office (SNIP); and had a worker on its board of directors. In 2008, a corruption scandal, related to the oil and gas concessions which resulted in the resignation of the Minister of Energy and Mines and the PetroPeru President, forced the Government of Peru to revise the 2006 law and implement a number of changes in the management of PetroPeru. PetroPeru will return under the control of the National Fund for Financing Government Companies (FONAFE), a government oversight entity. This will require their compliance with set regulations and norms, such as tight budget controls, contracting approval by OSCE (formerly CONSUCODE), and approval of its investment projects by SNIP. The Minister of Energy and Mines has stated that the state-owned company would not undertake oil exploration endeavors. The Government of Peru still wants to put Petroperu on the stock market, but it is not clear when this will happen. Petroperu has a strategic alliance with Brazil's Petrobras for oil and gas exploration-production and petrochemicals.

Corporate Social Responsibility

¶51. Peruvian businesses participate in Corporate Social Responsibility programs on primarily a voluntary level. For the energy and mining sector, certain regulations do exist to promote social responsibility. Decreto Supremo N???? 042-2003-EM - IT, promotes social responsibility within the mining sector including encouraging dialogue with the local communities, local employment, development activities, and purchase of local goods and services. The norm requires the mining companies to provide an annual report on sustainable development activities. The Peruvian Ministry of Energy and Mining offers on a voluntary basis a guidebook for community relations, as well as, providing on its website information on social measures pertaining to the mining and energy sectors.

Political Violence

¶52. Although political violence against investors is not a common practice, the mining and petroleum communities witnessed a series of protests, some violent, since 2005. In September 2007, residents of three northern Piura towns voted overwhelmingly in a referendum to reject mining projects in their region, which has stalled development of a large copper mining project. Other communities around Peru have expressed interest in holding similar referenda. Protests against the mining industry occurred for various reasons. Although environmental concerns were often the cited pretext, in many cases protestors were seeking social infrastructure investments not provided by the government. Often times, well-organized groups, such as the Ronderos (local self-defense groups that were instrumental in combating the Shining

Path terrorists in the 1980s and 1990s.) or NGOs, exaggerated a local community's concerns, bringing in protestors from outside the local community to foment protests against the companies. In several incidents since 2005, the local mayor and other local authorities led strikes against large foreign mining companies in an effort to secure additional funds or development promises from the companies. During 2009, there were road blockages and acts of vandalism by groups protesting mining operations, coca growers protesting the Government's eradication policies, and farmers seeking increased government tariff protections and financial support. A two month long protest of indigenous communities in the Amazon against a series of legislative decrees culminated in a violent clash on June 5, which left 24 police and 10 civilians dead. Protesters believed the decrees were legislated without proper prior consultation with indigenous communities. Some protesters also complained of the content of the decrees, and said the decrees favored private investors and extractive industries over indigenous communities. Concerns over the titling of indigenous lands and subsoil concessions continue to be potential sources of conflict, particularly in the Amazon.

¶53. Cabinet ministers and often the Prime Minister have become personally involved in negotiating a resolution to protests since the beginning of the Garcia Administration. The government established a commission in late 2006 to prevent and resolve social conflicts in the extractive industries. In addition, various NGOs have become involved in conflict resolution activities. At the same time, the National Society of Mining and Petroleum (SNMPE), as well as the government, have become involved in assisting local communities to access the extractive industry canons as a way to both stimulate local development and head off social conflicts. Although these efforts have been effective in some mining regions, in others, social conflicts have continued or expanded.

¶54. Political violence remains a concern in the coca-growing regions. The Shining Path (Sendero Luminoso) terrorist organization has become increasingly aggressive and involved in narcotrafficking in these areas. Sendero remnants are presumed to have killed more than 3 police, 26 civilians, and 19 members of the military, and committed more than 100 terrorist acts in coca-growing areas during 2009. The Shining Path killed 2 civilians, 11 police officers, and 17 military members in 2008, and were responsible for around 70 terrorist incidents that year. President Garcia continues to reauthorize 60-day states of

emergency in parts of Peru's four departments where the Shining Path operates, suspending some civil liberties and giving the armed forces additional authority to maintain public order.

¶55. There is little government presence in the remote coca-growing zones of the Monzon and the Apurimac-Ene River valleys. The U.S. Embassy in Lima restricts visits by official personnel to these areas because of the threat of violence by narcotics traffickers and remaining columns of the Shining Path. Information about insecure areas and recommended personal security practices can be found at http://www.ds-osac.org/.

Corruption

¶56. It is illegal in Peru for a public official or employee to accept any type of outside remuneration for the performance of his or her official duties. Peru has ratified both the UN Convention Against Corruption and the Organization of American States' Inter-American Convention Against Corruption. Peru is not a member of the Organization of Economic Cooperation and Development, and has not signed the OECD Convention on Combating Bribery.

¶57. Peru is one of four nations worldwide participating as a pilot country in the G8 anti-corruption and transparency initiative. The U.S., other G8 partners and NGOs helped the Peruvian government develop an action plan that includes activities in six areas: a) citizen information/internet connectivity; b) improving central government fiscal transparency; c) development of GOP procurement systems; d) improving regional/local government transparency and management; e) improvement of transparency of extractive industry revenues; and f) development of asset forfeiture systems and legislation.

¶58. The G8 initiative has already shown some positive results. A hemisphere-wide state procurement organization - the Inter-American Organization of Government Procurement Institutions - was created under the leadership of Peru's State Procurement Council OSCE (formerly CONSUCODE). As of January 2007, eight countries are in the process of adopting the network agreement, prior to its signature (Bolivia, Colombia, Ecuador, Honduras, Mexico, Paraguay, Peru and Paraguay). Also, efforts are underway to provide Internet connections to approximately 90 municipal governments located in areas most affected by terrorism and poverty. The rural connectivity project will allow these governments access to national systems, part of the GOP's E-government initiatives, aimed at creating greater transparency and citizen access to public information.

¶59. U.S. firms have reported problems directly resulting from corruption, usually in government procurement processes and in the judicial sector, but the revelation in late 2000 of a broad and deep corruption ring organized by former presidential advisor Vladimiro Montesinos heightened awareness of the problem. Transparency International ranked Peru number 75 (out of 180 countries) in its 2009 Corruption Perception Index. While anti-corruption efforts have been a stated priority of both the Toledo and Garcia Governments, in practice most resources are directed at investigating Fujimori-era corruption. In 2001, President Toledo appointed an anti-corruption "czar" to lead government efforts, but this official resigned in 2002. The Judge Carolina Lizarraga was appointed in October 2007 as the head of the newly created National Office for Anti-Corruption, but she resigned in July 2008. Private sector groups have increased efforts to combat corruption through an NGO called "ProEtica," which represents Transparency International in Peru. In October 2008, a kickback scandal involving a member of the ruling party and a foreign oil company led to the replacement of President Garcia's Prime Minister and the changing of five other cabinet members, although investigators have not established that the Prime Minister was involved in the scandal.

Bilateral Investment Agreements

¶60. Peru has signed bilateral investment agreements with 32

countries (listed below), but not with the United States. The U.S.-Peru Trade Promotion Agreement (PTPA), signed by President Bush on December 14, 2007 and entered into force on February 1, 2009, eliminates the need for a bilateral investment agreement.

¶61. Peru's Current Bilateral Investment Agreements:

Argentina (1994)

Ecuador (1999)

Paraguay (1994)

Australia (1995)

El Salvador (1997)

Portugal (1994)

Belgium-Luxembourg E.U. (2005)

Finland (1995)

Romania (1994)

Bolivia (1993

France (1993)

Singapore (2003)

Canada (2006)

Germany (1995)

Spain (1994)

Chile (2000)

Italy (1994)

Sweden (1994)

China (1994)

Japan (2009)

Switzerland (1991)

Colombia (1994)

Korea (1993)

Thailand (1991)

Cuba (2000)

Malaysia (1995)

United Kingdom (1993)

Czech Rep (1994)

Netherlands (1994)

Venezuela (1996)

Denmark (1994)

Norway (1995)

OPIC and Other Investment Insurance Programs

¶62. The Overseas Private Investment Corporation (OPIC), an independent U.S. Government agency, offers medium- to-long-term financing and political risk insurance. OPIC signed two agreements with Peru in December 1992, and in July 1994, OPIC approves requests for political risk insurance (including for inconvertibility of currency). In 2008, OPIC announced that its

Board of Directors approved $350 million in financing for three new private equity investment funds that will provide capital to a host of sectors in the economies of Latin America. OPIC designated Peru as a beneficiary for all three funds. The following sectors will be targeted: telecommunications, finance, agribusiness, tourism, real estate, natural resources, energy, water and waste management, transportation, infrastructure, and services.

¶63. Because of the free convertibility of currency, the U.S. Embassy purchases Peruvian currency for expenses on an as-needed basis, at the market exchange rate. The U.S. dollar remained at about 2.8 Nuevo Sol to the dollar throughout 2009. Peru is a member of the Multilateral Investment Guarantee Agency.

Labor

¶64. Labor is abundant and trainable, although there are shortages of highly skilled workers in some fields and wages for professional staff are high (sometimes higher than U.S. wages in the mining sector for positions in the managerial and consulting fields). On October 1, 2007, the government increased the statutory monthly minimum wage by 10 percent to 550 Nuevos Soles (about US$180.) Some workers, like miners, are highly paid and also (per statute) receive a share of company profits. On July 1, 2008, mining workers began an unsuccessful indefinite national strike to force lawmakers to pass a law that would remove the cap mining workers receive on their share of company profits. The law provides for a 48-hour workweek and one day of rest and requires companies to pay overtime for more than eight hours of work per day and additional compensation for work at night. Unions in essential public services, as determined by the government, must provide a sufficient number of workers during a strike to maintain operations. The law bans government unions in essential public services from striking. However, in September 2008 the public health sector workers went on strike to demand owed back pay, better pay and resources to treat patients. The strike ended 38 days later with formal talks between the union and the government. The law also requires strikers to notify the labor ministry in advance before carrying out a job action. According to the labor ministry, seven legal strikes and 84 illegal strikes took place between January and November 2009. According to labor leaders, permission to strike was difficult to obtain, in part because the labor ministry feared harming the economy. The Ministry of Labor justified its decisions by citing unions' failure to fulfill the legal requirements necessary to strike.

¶65. The presence of organized labor in the Peruvian economy has declined; in 2007, 7.06 percent of the labor force was organized. Unemployment in Lima officially stood at 8.6% during the fourth quarter of 2008, compared with 8.4% a year earlier. Surveys show that 48.9% of Lima's economically active population was underemployed in 2008 (51.7% in 2007 and 52.4% in 2006), mostly working as self-employed in the informal sector for below subsistence wages.

¶66. In 1992, a new labor law and other related statutes replaced extremely inflexible old statutes and regulations. The new laws allow for multiple forms of unions across company or occupational lines, thus permitting multiple unions in the same company. According to labor leaders the law has weakened unions, as companies create competiting unions that are seen as more favorable to management. Workers in probation status or on short-term contracts are not eligible for union membership. Bargaining agreements are considered contractual agreements, valid only for the life of the contract. Productivity provisions must be included in any collective bargaining agreement. The number of officials and the amount of time union officials may devote to union work with pay is limited to 30 days per year. Unless there is a pre-existing labor contract covering an occupation or industry as a whole, unions must negotiate with each company individually. A labor law passed in July 1995 liberalized hiring. Business leaders lauded the above changes, saying they led to greater efficiency. Labor leaders disagreed, arguing that the new labor laws eroded labor protections and encouraged outsourcing in a way that undercuts union activity.

¶67. With Peru's return to democracy in 2000, Peruvian organized

labor regained some, but not all, of the protections enjoyed in the pre-Fujimori era. A decision by the Constitutional Tribunal in 2004, for example, legitimized collective industry-wide bargaining in the civil construction industry. Labor leaders saw this as a potential precedent to be applied to other activities, but that has not yet happened. Furthermore, new laws added to labor inflexibility because the restrictions for termination and downsizing have made businesses reluctant to hire new employees and have created incentives to outsource. A new law passed on 2008 created more restrictions on outsourcing and subcontracting, made the contracting company more responsible for the actions of their subcontracted company, and created a national registry of contracting companies. The PTPA requires Peru to respect the ILO-defined core labor rights of its workers, and at the close of 2009 the GOP was set to establish a labor council to monitor progress to this end.

¶68. Either unions or management can request binding arbitration in contract negotiations. Strikes can be called only after approval by a majority of all workers (union and non-union) voting by secret ballot and only in defense of labor rights. Unions in essential public services, as determined by the government, must provide a sufficient number of workers during a strike to maintain operations.

¶69. The 1993 Constitution provides for a maximum workday of eight hours, with 48 hours as the maximum week. The labor code also sets 24 hours rest per week and 30 days paid annual vacation for all workers. In 2008, a new law reduced severance pay and bonuses by 50% and paid annual vacation to 15 days for small business workers. Workers readily sacrifice these and other benefits in exchange for regular employment. In 2008, a new law gave micro-business workers social security and pensions. Strike activity declined markedly over the ensuing nine years and since new labor laws were passed, worker efficiency rose substantially. However, strikes and militant industrial action continue to increase. The overall number of strikes fell in 2008. Through September 2008, there were 53 strikes with a loss of 1, 397,188 man-hours, compared with 55 strikes and a loss of 1,366,272 man-hours in the same period of ¶2007.

¶70. Congress continues to debate a comprehensive labor law reform, which may result in a return to inflexibility of the conditions of dismissal for employees.

Foreign-Trade Zones/Free Ports

¶71. Peruvian law currently covers two types of free trade zones: export, transformation, industry, trade and services zones (CETICOS), and a free trade zone (ZOFRATACNA) in Tacna. The rules and tax benefits applying to these zones are the same for foreign and national investors.

¶72. Companies established at the CETICOS and ZOFRATACNA, which export no less than 92 percent of their output (more than 80 percent of production for the Loreto CETICOS and more than 50 percent for ZOFRATACNA), are exempted until 2012 from all taxes, dues and contributions to the central government and municipalities, particularly income, sales (IGV), Municipal Promotion (IPM) and excise (ISC) taxes. CETICOS exist at Ilo, Matarani and Paita, with one authorized but not operating at Loreto. There is a concern that the Peruvian Government does not have the proper WTO waivers to validate the CETICOS export

requirement. The U.S. automotive industry has expressed a specific concern that U.S. brands are unable to compete with used Japanese vehicles that enter the Peruvian market duty-free through the CETICOS. The Ministry of Transportation and Communications plans to ban the importation of used vehicles by 2010, citing environmental and security concerns.

Foreign Direct Investment Statistics

¶73. The stock of foreign direct investment in Peru was US$34.7 billion at the end of September 2009 according to Peru's Central

Bank, versus US$30.2 billion in December 2008. The U.S. Department of Commerce reported that U.S. direct investment in Peru on a historical-cost basis was over $8.4 billion in 2008, making the U.S. Peru's largest foreign investor. Foreign direct investment registered with ProInversion for the purposes of legal stability contracts reached US$18.4 billion by September 2008. Of these Spanish investors held the largest share (23 percent), with US$4.1 billion invested. The United Kingdom was the second largest investor, with US$3.6 billion, and the United States third, with US$2.7 billion. By sector, the mining industry received 20.3 percent of foreign direct investment, followed by the communication industry (20.06 percent), manufacturing (15.4 percent), and finance (15. 15.2 percent)

¶74. As of the end of December 2009, investors and companies had signed 715 legal stability contracts with the Government of Peru through ProInversion. Legal stability contracts commit the government not to apply any future changes in the income tax, labor and other laws governing a specific investment in exchange for commitments to invest a given amount. Those contracts offer legal stability for ten years, or for the duration of the concession in the case of concession contracts. In addition to these contracts, the Government of Peru has signed numerous tax, foreign exchange and administrative stability contracts through several ministries, mainly the Ministry of Energy and Mines. Investors may subscribe to a legal stability contract with a minimum investment of US$10 million in the mining and oil industries and US$5 million in other sectors.
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